**COMMENT OF THE GLOBAL ANTITRUST INSTITUTE,
ANTONIN SCALIA LAW SCHOOL, GEORGE MASON UNIVERSITY,
ON THE PROPOSED AMENDMENTS TO THE COMPETITION LAW
OF THE SOCIALIST REPUBLIC OF VIETNAM**

May 7, 2017

This comment is submitted to the Vietnam Competition Authority (VCA) on the proposed amendments to the Competition Law of the Socialist Republic of Vietnam. We submit this comment based upon our extensive experience and expertise in antitrust law and economics.[1]

INTRODUCTION

This comment is limited to Article 10 on Market Power and Chapter IV on Abuse of Dominant Position on the Market. Specifically, we strongly urge that the definitions of market power and of dominant market position in Articles 10 and 18, respectively, be revised to align with the modern economic understanding of those terms. Specifically, we recommend that market power and dominant market position be defined to require an entity have the ability to profitably increase market prices above or to reduce market output below competitive levels for a significant period of time. As explained below, the primary benefit of accepting this recommendation is to bring the Competition Law in line with modern economics, which counsels a shift away from using market shares alone to predict whether a firm possesses market power or is likely able to increase prices.

We also recommend that Article 20, which sets forth prohibited acts by dominant firms, be revised to eliminate all presumptions of illegality. Instead, we recommend Article 20 explicitly recognize that the vast majority of conduct within the domain of Article 20 may be either procompetitive or competitively neutral, and as such should be analyzed under the "rule of reason," or under an effects-based approach in which restraints are condemned only when any anticompetitive harm they may cause outweighs any procompetitive benefits they create.

Modern economics counsels against presuming competitive harm. Indeed, economic theory, empirical evidence, and experience teach that vertical restraints (which include vertical territorial restrictions, resale price maintenance, exclusive dealing, loyalty discounts, tying, and

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[1] The Global Antitrust Institute (GAI), a division of the Antonin Scalia Law School at George Mason University (Scalia Law), is a leading international platform for economic education and research that focuses upon the legal and economic analysis of key antitrust issues confronting competition agencies and courts around the world. University Professor Joshua D. Wright, Ph.D. (economics), is the Executive Director of the GAI and a former U.S. Federal Trade Commissioner. Koren W. Wong-Ervin is the Director of the GAI, and Adjunct Professor at Scalia Law, and former Counsel for Intellectual Property and International Antitrust at the U.S. Federal Trade Commission. Professor of Law Douglas H. Ginsburg is a Senior Judge, United States Court of Appeals for the District of Columbia Circuit, Chairman of the GAI's International Board of Advisors, and a former Assistant Attorney General in charge of the Antitrust Division of the U.S. Department of Justice. Associate Dean for Research and Faculty Development and Professor of Law Bruce H. Kobayashi, Ph.D. (economics), is a GAI Senior Scholar and Founding Director.

other related business practices) rarely harm competition and often benefit consumers by reducing costs, aligning manufacturer and distributor incentives by decreasing free-riding, lowering price, increasing demand by inducing greater supply of promotional services, or creating a more efficient distribution channel.[2] As the U.S. Federal Trade Commission's (FTC's) former Director of the Bureau of Economics explained when summarizing the body of economic evidence analyzing vertical restraints, "it appears that when manufacturers choose to impose [vertical] restraints, not only do they make themselves better off but they also typically allow consumers to benefit from higher quality products and better service provision."[3]

SPECIFIC RECOMMENDATIONS

Article 10. Factors to determine market power of enterprise(s)

We strongly urge that Article 10 be revised to state that an entity will be found to have market power only if it is able profitably to maintain market prices above or market output below competitive levels for a significant period of time. As is, Article 10 focuses primarily upon factors such as market share, market structure, and ownership of "essential" facilities. This focus is likely to invite errors when attempting to identify market power.

Indeed, there is very little empirical basis to presume any systematic relationship between concentration and market power.[4] While older studies provided some empirical support for the market concentration doctrine, newer studies have not. Instead, "correlations between market concentration and various measures of market power turn out to be less persistent and considerably weaker or even nonexistent than in the earlier work."[5] Similarly, there is very little empirical basis to presume any systematic relationship between market structure, competition, and innovation. While there is credible causal evidence that market incentives matter,[6] the

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[2] *See, e.g.*, James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639, 642, 658 (2005) (surveying the empirical literature, concluding that although "some studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition," and, "in most of the empirical studies reviewed, vertical practices are found to have significant pro-competitive effects"); Benjamin Klein, *Competitive Resale Price Maintenance in the Absence of Free-Riding*, 76 ANTITRUST L.J. 431 (2009); Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling by Firms? A Survey of the Economic Literature*, 1 J. COMP. L. & ECON. 707 (2005); Daniel P. O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems*, *in* THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 72–76 (2008) ("[W]ith few exceptions, the literature does not support the view that [vertical restraints] are used for anticompetitive reasons" and "[vertical restraints] are unlikely to be anti-competitive in most cases.").

[3] Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, *in* HANDBOOK OF ANTITRUST ECONOMICS 391 (Paolo Buccirossi ed., 2008).

[4] *See, e.g.*, Harold Demsetz, *The Market Concentration Doctrine: An Examination of Evidence and a Discussion of Policy*, AEI-Hoover Policy Study 7 (Aug. 1973).

[5] *Id.* at 1.

[6] *See generally* Daron Acemoglu & Joshua Linn, *Market Size in Innovation: Theory and Evidence from the Pharmaceutical Industry*, 119 AM. ECON. REV. 1049 (2004) (linking innovation rates to current and

empirical literature attempting to link market structure—typically measured by the number of firms or market shares in broadly defined markets—and product market competition to innovation is based on cross-sectional analyses that do not support a causal inference[7] and as a whole yields inconclusive results.[8] While competition certainly can stimulate innovation, economic analysis provides no reason to believe innovation ordinarily will come from within a "market" as defined for the purpose of antitrust analysis; hence there is little reason to believe proxies for dynamic competition will be positively correlated with innovative activity observed in such a market. Richard Gilbert's careful examination of the empirical record reaffirms that the existing body of theoretical and empirical literature on the relationship between competition and innovation supports neither "the Schumpeterian hypothesis that monopoly promotes either investment in R&D or the output of innovation" nor "a strong conclusion that competition is uniformly a stimulus to innovation."[9] In other words, market structure, as presently defined by reference primarily to market shares and ease of entry, provides at best a very crude signal of the likely impact a merger or single-firm conduct will have upon future competition.

It is also worth noting that there has been a movement away from focusing upon market definition and market power to infer competitive effects. In particular, the United States' competition agencies increasingly have shifted their focus to a direct assessment of incentives and competitive effects, as evidenced by the 2010 Horizontal Merger Guidelines, and away from using market shares to predict whether a firm possesses market power or is likely to increase prices. This shift in antitrust analysis is consistent with modern economics and is particularly important in matters involving intellectual property rights (IPRs); IPR holders may need relatively high margins (prices above marginal cost) merely to recoup their upfront investment and compensate for the substantial risks associated with seeking to create and commercialize intellectual property. Prices well above their low or even zero marginal cost are normal features of competitive markets in such industries, such as pioneer pharmaceuticals. In other words, a price above marginal cost in such an industry may result in no more than the competitive rate of return on the investment necessary to create the IPR.[10] Relatedly, the lines between markets may be not be clearly delineated in high-tech markets involving IPRs, such as smart phones. To infer a firm has market power based merely upon its high market share or its ability to charge a price

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future market size); Eric Budish et al., *Do Firms Underinvest in Long-term Research? Evidence from Cancer Clinical Trials*, 105 AM. ECON. REV. 2044 (2015) (concluding that patient groups with longer commercialization lags tend to have lower levels of R&D investment).

[7] *See, e.g.*, Philippe Aghion et al., *Competition and Innovation: An Inverted U-Relationship*, 120 Q.J. ECON. 701 (2005).

[8] *See, e.g.*, Richard J. Gilbert, *Looking for Mr. Schumpeter: Where Are We in the Competition–Innovation Debate?*, *in* 6 INNOVATION POLICY AND THE ECONOMY 159, 164 (Adam B. Jaffe et al. eds., 2006) ("The many different predictions of theoretical models of R&D lead some to conclude that there is no coherent theory of the relationship between competition and investment in innovation."); Joshua D. Wright & Douglas H. Ginsburg, *Dynamic Analysis and the Limits of Antitrust Institutions*, 78 ANTITRUST L.J. 1, 4–5 (2012).

[9] Richard J. Gilbert, *Competition and Innovation*, *in* 1 ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 577, 600 (W. Dale Collins ed., 2008).

[10] *See generally* Benjamin Klein & John Shepard Wiley Jr., *Competitive Price Discrimination As An Antitrust Justification for Intellectual Property Refusals to Deal*, 70 ANTITRUST L.J. 599 (2003).

greater than marginal cost is to invite error.

Article 18. Enterprises, groups of enterprises holding the dominant position on the market

We strongly urge that Article 18(1), which sets out market shares above which a dominant market position would be presumed, be omitted in its entirety. Instead, we recommend Article 18 (1) state that an entity will be found to have a dominant market position only if it is able profitably to maintain market prices above or market output below competitive levels for a significant period of time. Presumptions based upon market shares discourage more rigorous effects-based economic analyses of the restraint at issue in favor of relying upon easier to apply but less accurate forms of analysis. Further, the experience in the United States counsels that a market share of 30 percent is too low to provide a firm with market power, and that even when a firm has a high market share (e.g., above 60 or 70 percent), whether the firm has a dominant market position is a fact-specific issue that must be analyzed on a case-by-case basis. Such an analysis includes an examination of barriers to entry, the likelihood of leapfrog competition, and the durability of high market shares, to determine whether the firm actually has the power profitably to maintain prices above or output below competitive levels for a significant period of time.

We also highly recommend that Article 18(2), which provides for presumptions concerning collective dominance, be omitted in its entirety. These presumptions may harm rather than promote competition. For example, treating the second and third largest firms in a market as dominant is likely to deter them from competing aggressively against the market leader, which is likely to harm competition given that they are often in the best position to compete most effectively against the market leader. As such, we respectfully urge that this provision be omitted in its entirety, or at the very least, revised to require concerted action as a joint monopoly, which is the approach generally required by the European Commission.

Article 20. Enterprises, groups of enterprises holding the dominant position on the market

We strongly urge that Article 20, which sets forth prohibited act for dominant firms, be revised to eliminate all presumptions of illegality and instead adopt on effects-based approach in which conduct is condemned only when any anticompetitive harm they cause outweighs any procompetitive benefits they create.

The default method of evaluating antitrust-relevant conduct is the rule of reason, which involves costly, comprehensive weighing of any pro- and anticompetitive effects of the challenged conduct. Truncated analysis such as presumptions of illegality, by way of comparison, harnesses decision theory to develop shorthand analytical tools based upon judicial and market experience with the restraint at issue, as well as accumulated economic knowledge to identify conduct that is likely to harm competition.[11] Truncated analysis is appropriate when it,

[11] Joshua D. Wright, Comm'r, FED. TRADE COMM'N, Intellectual Property Rights, Truncation, and *Actavis*: Who's Afraid of the Rule of Reason?, Remarks at the Global Competition Review Live 2nd Annual IP & Antitrust USA 2-3 (Apr. 14, 2015), https://www.ftc.gov/system/files/documents/public_statements/636901/150414gcr-ip-antitrust.pdf.

rather than the full-blown or unstructured rule of reason, minimizes the sum of the error costs and the administrative costs of adjudicating antitrust claims. The benefit of truncation is that it economizes on existing judicial and economic knowledge to produce more efficient legal rules. In short, truncated analysis is at its core intended to be an easily administrable, effects-based application of the rule of reason.[12] As the Supreme Court has recognized, the "abandonment of the 'rule of reason' in favor of presumptive rules (or a 'quick-look' approach) is appropriate only where 'an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets.'"[13] As explained below, none of the conduct prohibited by Article 20 satisfies this criteria.

With respect to determining harm to competition from anticompetitive foreclosure, we recommend that the VCA take cognizance only of *substantial* foreclosure effects, that is, "foreclosure of a sufficient share of distribution so that a manufacturer's rivals are forced to operate at a significant cost disadvantage for a significant period of time."[14] Substantial foreclosure sufficient to deprive a rival of the opportunity to compete for minimum efficient scale is necessary for vertical conduct to potentially create or maintain market power.[15] Measuring foreclosure of the critical input requires an understanding of the minimum efficient scale of production. Experience in the United States has led to the conclusion that "[u]nless there are very large economies of scale in manufacturing, the minimum foreclosure of distribution necessary for an anticompetitive effect in most cases would be substantially greater than 40 percent. Therefore, 40 percent should be thought of as a useful screening device or 'safe harbor,' not an indication that anticompetitive effects are likely to exist above this level."[16]

We also strongly urge the VCA to include an analysis of the counterfactual world, i.e., to identify "the difference between the percentage share of distribution foreclosed by the allegedly exclusionary agreements or conduct and the share of distribution in the absence of such an agreement."[17] Such an approach to assessing foreclosure isolates any true competitive effect of the allegedly exclusionary agreement from other factors.

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[12] ANDREW I. GAVIL ET AL., ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY 185–87 (2d ed. 2008); Timothy J. Muris & Brady P.P. Cummins, *Tools of Reason: Truncation Through Judicial Experience and Economic Learning*, ANTITRUST, Summer 2014, at 46, 46–47, 50.

[13] *FTC v. Actavis*, 133 S. Ct. 2223, 2237 (2013) (quoting *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 770 (1999)).

[14] Benjamin Klein, *Exclusive Dealing as Competition for Distribution "On the Merits"*, 12 GEO. MASON L. REV. 119, 122-28 (2003).

[15] Joshua D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19 GEO. MASON L. REV. 1163, 1166 (2012) (collecting sources). *See also* Derek W. Moore & Joshua D. Wright, *Conditional Discounts and the Law of Exclusive Dealing*, 22 GEO. MASON L. REV. 1205 (2015).

[16] Klein, *supra* note 14, at 126.

[17] Wright, *supra* note 15, at 1165.

Predatory Pricing

We recommend that Article 20(1) be revised as follows:

Selling goods, providing services at prices ~~lower than the aggregate costs without plausible reasons,~~below an appropriate measure of its rival's cost with a reasonable prospect or dangerous probability of recouping its investment in below cost prices.

The standard for predatory pricing we recommend for the VCA is the one adopted by the U.S. Supreme Court in *Brooke Group v. Brown & Williamson Tobacco.*[18] In that case, the U.S. Supreme Court adopted a two-part, difficult for plaintiffs to satisfy rule in response to concerns about the costs of administering an antitrust rule to control predatory pricing. In particular, the Court expressed concern over the costs of chilling legitimate price competition:

> Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition . . . We have adhered to this principle regardless of the type of antitrust claim involved. As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting. To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result.[19]

Phillip Areeda and Herbert Hovenkamp also express similar concerns:

> The reason these [permissive] tests for predatory pricing were adopted was *not* because there is widespread consensus that above-cost pricing strategies can never be anticompetitive in the long run. Rather, it is because our measurement tools are too imprecise to evaluate such strategies without creating an intolerable risk of chilling competitive behavior.[20]

With respect to the appropriate measure of cost, the most influential test of predation is the cost-based test of Areeda and Turner (AT), under which prices above short-run marginal cost would be lawful and prices below short-run marginal cost would be unlawful.[21] Because prices

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[18] 509 U.S. 209 (1993).

[19] *Id.* at 223 (internal quotations and citations omitted).

[20] 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION § 749 (3d ed. 2008).

[21] Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

would be driven to marginal cost in competitive equilibrium, AT did not want a rule that would prevent competitive pricing by making prices above marginal cost unlawful. In contrast, prices below marginal cost are not consistent with a competitive equilibrium, and would require that the predatory firm sacrifice profits.[22] AT would use average variable cost (AVC) as a more easily observable proxy given the difficulties of observing and measuring marginal cost. Under the AT test, prices below AVC would be presumptively unlawful. However, because it may be rational for a firm maximizing profits to ignore non-recurring fixed costs, prices above AVC but below average total cost (ATC) would not be presumptively unlawful,[23] and prices above ATC would be lawful.[24] Like the U.S. Supreme Court's *Brooke Group* decision, the AT test "weights heavily both the potential costs of deterring competitive price cutting, and the benefits of having a well-defined, administrable standard."[25]

With respect to the recoupment element, as the Court explained, "[w]ithout recoupment, even if predatory pricing causes the target painful losses, it produces lower aggregate prices in the market, and consumer welfare is enhanced."[26]

Resale Price Maintenance (RPM)

With respect to Article 20(2), which prohibits a dominant firm from "[i]mposing irrational buying or selling prices of goods or services or fixing minimum re-selling prices," we recommend the following revision: "setting minimum resale prices resulting in anticompetitive harm, such as reduced output, that is not outweighed by any procompetitive benefits they create."

"Economists nearly universally agree that while minimum RPM can generate anticompetitive outcomes in some instances, the empirical evidence indicates such agreements are more often than not procompetitive."[27] Among the early empirical evidence on RPM is a 1983 report by Thomas Overstreet analyzing 68 FTC RPM cases from mid-1965-1982 and

[22] Bruce H. Kobayashi, *The Law and Economics of Predatory Pricing*, *in* 4 ENCYCLOPEDIA OF LAW AND ECONOMICS: ANTITRUST LAW AND ECONOMICS 116, 130-1 (Keith N. Hylton ed., 2d ed. 2010) (citations omitted).

[23] U.S. courts have generally held that prices between AVC and ATC are lawful. *See* Areeda & Hovenkamp, *supra* note 20, at § 724. AT would also exempt below-cost pricing from antitrust liability in specific situations. For example, when a new entrant's promotional prices are below cost. *Id.* at § 749c4.

[24] *Id* at § 739c3.

[25] Kobayashi, *supra* note 22, at 131.

[26] *Brooke Grp.*, 509 U.S. at 224.

[27] Joshua D. Wright, Comm'r, FED. TRADE COMM'N, The Economics of Resale Price Maintenance & Implications for Competition Law and Policy, Remarks Before the British Institute of International and Comparative Law 16 (2014), https://www.ftc.gov/system/files/documents/public_statements/302501/140409rpm.pdf (collecting studies).

surveying the empirical studies on RPM available at the time.[28] Overstreet observed that an overwhelming number of the RPM cases brought and resolved by the FTC occurred in markets that were not conducive to either dealer or manufacturer collusion, and therefore concluded that RPM agreements generally are procompetitive.[29] Overstreet's survey of the existing empirical work showed that although RPM can have both socially desirable and undesirable consequences, the studies did not support the conclusion that RPM agreements are more often than not anticompetitive.[30]

In a 1991 study, Pauline Ippolito reviewed 203 litigated RPM cases reported from 1975 through 1982, concluding that they were generally inconsistent with theories of dealer or manufacturer collusion.[31] In particular, Ippolito observed that allegations of horizontal price-fixing in these cases was exceedingly rare—appearing only 9.8 percent of the time in private cases and 13.1 percent of the time over all cases—even though that claim logically would have been included by plaintiffs if they had any evidence that the RPM arrangements in question reflected dealer or manufacturer collusion.[32] Moreover, most of the cases offered facts suggesting procompetitive justifications for the use of RPM. This led Ippolito to conclude that "service- and sales-enhancing theories, taken together, appear to have greater potential to explain the [RPM] practices" than do collusion-based explanations.[33]

Two more recent empirical surveys summarizing the empirical literature on vertical restraints offer additional evidence casting doubt on the proposition that minimum RPM is always or even usually anticompetitive. The first, authored by a group of U.S. Department of Justice (DOJ) and FTC economists, reviews twenty-four papers published between 1984 and 2005 providing empirical effects of vertical integration and vertical restraints.[34] The study offers a careful synthesis of the evidence and observes that "empirical analyses of vertical integration and control have failed to find compelling evidence that these practices have harmed competition, and numerous studies find otherwise."[35] While only a handful of the selected studies involve only RPM rather than additional forms of vertical restraints, the authors go on to conclude that while "[s]ome studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition."[36]

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[28] THOMAS R. OVERSTREET, JR., BUREAU OF ECON., FED. TRADE COMM'N, RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE (1983).

[29] *Id.*

[30] *Id.*

[31] Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263 (1991).

[32] *Id.* at 281.

[33] *Id.* at 291-92.

[34] Cooper et al., *supra* note 2.

[35] *Id.* at 658.

[36] *Id.*

The second recent empirical survey, by former-FTC Director of the Bureau of Competition Francine Lafontaine and Margaret Slade, reviews twenty-three papers, including some in the study prepared by the DOJ and FTC economists.[37] Lafontaine and Slade reach a similar conclusion, stating that "it appears that when manufacturers choose to impose restraints, not only do they make themselves better off, but they also typically allow consumers to benefit from higher quality products and better service provision . . . the evidence thus supports the conclusion that in these markets, manufacturer and consumer interest are apt to be aligned."[38]

In an even more recent analysis of RPM, along with the related practices of exclusive territories and forward integration, FTC economist Dan O'Brien notes that three additions to the literature provide new evidence that such restraints mitigate double marginalization and promote retailer effort.[39] O'Brien goes on to conclude that, "with few exceptions, the literature does not support the view that these practices are used for anticompetitive reasons," and supports "a fairly strong prior belief that these practices are unlikely to be anticompetitive in most cases."[40]

The robust empirical literature that has examined the competitive effects of minimum RPM does not suggest that minimum RPM arrangements "usually have significant anticompetitive effects," and we urge the JFTC to reconsider both its statement regarding the general effects of minimum RPM and its approach to regulating RPM through antitrust or competition laws. With respect to measuring the welfare effects of minimum RPM, agencies need to assess both price and output effects. This is because, "[f]rom a consumer welfare perspective, measuring the effect of minimum RPM on price alone tells us little about the competitive effects of minimum RPM because both procompetitive and anticompetitive theories predict higher prices, all else equal. Analyzing the effect of minimum RPM on output, where the theories offer predictions in opposing directions, resolves this problem."[41]

Discriminatory Dealing

Article 20(4) prohibits a dominant firm from "[i]mposing dissimilar commercial conditions in similar transactions in order to create inequality in competition." For the following reasons, we strongly urge against this approach.

First, the standard ("to create inequality in competition") is ambiguous.

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[37] Lafontaine & Slade, *supra* note 3.

[38] *Id.* at 408–09.

[39] O'Brien, *supra* note 2.

[40] *Id.* at 76.

[41] Wright, *supra* note 26, at 16.

Second, in general, the welfare effects of price discrimination are mixed,[42] which supports the use of an effects-based approach that recognizes both the anticompetitive uses of price discrimination and the ubiquitous use of price discrimination to improve efficiency, grow markets, intensify competition, and enhance consumer welfare. For example, differential pricing can improve efficiency, grow markets, intensify competition, and enhance consumer welfare. Differential pricing can allow firms to expand output, which can be welfare enhancing. Profit-maximizing firms facing distinct consumer demands for a product may reduce prices for the more price-sensitive customers and increase price to the less price-sensitive customers relative to uniform pricing. Differential pricing can therefore enable the firm to reach consumers that would otherwise not purchase the product. Price discrimination may also intensify competition by enabling firms to selectively meet competitor's prices.[43]

In addition, differential pricing helps a firm with fixed costs to recover its outlays and is sometimes necessary for a firm to recover those outlays.[44] Indeed, an important aspect to consider in evaluating differential pricing in licensing as compared to differential pricing for physical goods is the nature of intellectual property (IP) development. The innovation process typically involves large upfront investments in research and development yet very low marginal costs at the production stage. Economists have observed that differential pricing can be an important mechanism for recovering fixed costs under these circumstances.[45]

Similarly, discriminatory refusals to license or licensing to different parties on different terms may serve legitimate, procompetitive ends. For example, a business may grant licenses to some, but not all, interested potential licensees in order to ensure that licensees have a greater incentive to promote the licensor's technology. Alternatively, in order to maximize its income from the patent, a business may require higher royalties from a company that has lower sales volume or offer lower royalties to a licensee that can offer valuable consideration in trade, such as a cross-license of its IP, which may be netted against the price of a license.

In the United States, nearly all concern over potentially harmful discriminatory licensing has centered on the practices of vertically integrated firms that both hold patents and practice them in a downstream market. This is because a nonintegrated patent holder, with no downstream operations, has less to gain by discriminating among licensees with whom it does

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[42] *See generally* Hal R. Varian, *Price Discrimination*, *in* 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 597, 619–22 (Richard Schmalensee & Robert D. Willig eds., 1989); Hal R. Varian, *Price Discrimination and Social Welfare*, 75 AM. ECON. REV. 870 (1985).

[43] Jacques F. Thisse & Xavier Vives, *On the Strategic Choice of Spatial Price Policy*, 78 AM. ECON. REV. 122, 134 (1988); *see also* James C. Cooper et al., *Does Price Discrimination Intensify Competition? Implications for Antitrust*, 72 ANTIRUST L.J. 327 (2005).

[44] Anne Layne-Farrar, *Nondiscriminatory Pricing: Is Standard Setting Different?*, 6 J. COMPETITION L. & ECON. 811, 827 (2010) (citing William J. Baumol & Daniel G. Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power, Symposium on Competitive Price Discrimination*, 70 ANTITRUST L.J. 661 (2003)).

[45] *Id.*; *see also* CARL SHAPIRO & HAL R. VARIAN, INFORMATION RULES: A STRATEGIC GUIDE TO THE NETWORK (1999); Baumol & Swanson, *supra* note 44.

not compete.[46] Nonintegrated firms will have an incentive to engage in anticompetitive licensing discrimination only if it increases their total royalty revenues, but often it is increased downstream competition that maximizes the upstream patentee's royalty earnings.[47] If the patent holder is not vertically integrated, then the analysis of allegations of discriminatory licensing should be scrutinized even more rigorously because the circumstances under which an upstream patent holder would have an incentive to disadvantage one downstream licensee over another are narrower.[48] Lastly, the possibility of market expansion and other efficiencies, including the coverage of research and development investments, indicates the need for a cautious approach to assessing discrimination in licensing even when vertically integrated firms are involved.

Exclusive Dealing

Article 20(7) prohibits dominant firms from "[r]equiring other enterprises just to deal with itself or with enterprises appointed by it." For the following reasons, we strongly urge against this per se illegality approach and instead recommend an effects-based approach.

First, although the existing empirical evidence of the impact of exclusive dealing is scarce, it generally favors the view that exclusive dealing is output-enhancing, which supports our recommendation against per se illegality. For example, Jan Heide et al. conducted a survey of managers responsible for distribution decisions and found that the incidence of exclusive dealing was correlated with the presence of "free-ridable" investments.[49] John Asker and Tim Sass separately examine the welfare consequences of exclusive dealing in the beer market by observing the effect of exclusive dealing on total market output, as well as the output and prices of rival distributors, concluding that exclusive dealing is output increasing and does not generate foreclosure.[50]

Second, not only are exclusive dealing arrangements often "efficient and result from the normal competitive process," but they are also "often observed between firms lacking any meaningful market power, implying that there must be efficiency justifications for the practice."[51] The standard procompetitive account of exclusive dealing contracts involves preventing dealers from free-riding by using manufacturer-supplied investments to promote rival

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[46] *See, e.g.*, Herbert Hovenkamp et al., *Unilateral Refusals to License*, 2 J. COMPETITION L. & ECON. 1, 16 (2006).

[47] Layne-Farrar, *supra* note 44, at 825.

[48] *Id.* at 828.

[49] Jan B. Heide et al., *Exclusive Dealing and Business Efficiency: Evidence from Industry Practice*, 41 J.L. & ECON. 387 (1988).

[50] *See* John Asker, *Diagnosing Foreclosure Due to Exclusive Dealing*, 64 J. INDUS. ECON. 375 (2016); Tim R. Sass, *The Competitive Effects of Exclusive Dealing: Evidence from the U.S. Beer Industry*, 23 INT'L J. INDUS. ORG. 203 (2005).

[51] Alden F. Abbott & Joshua D. Wright, *Antitrust Analysis of Tying Arrangements and Exclusive Dealing*, in 4 ENCYCLOPEDIA OF LAW AND ECONOMICS: ANTITRUST LAW AND ECONOMICS 183, 196–97 (Keith N. Hylton ed., 2d ed. 2010).

products.[52] For example, a manufacturer may purchase display fixtures or train salespeople. Dealer free-riding involves using these investments to promote rival brands.

Benjamin Klein and Andres Lerner demonstrate how exclusivity minimizes free-riding in cases when there are no manufacturer supplied investments, namely in situations involving free-riding on manufacturer paid-for promotion to sell rival products, and free-riding in the form of failing altogether to supply the promotion paid for by the manufacturer, even in the absence of dealer switching.[53] With respect to the first type of free-riding, because manufacturers often compensate retailers for the provision of promotional services such as premium shelf space,[54] dealers have the incentive to use these additional promotional efforts to switch consumers to other products upon which the dealer earns a greater profit. Exclusive dealing can be used to prevent this type of free-riding in an analytically identical manner to the way it prevents free-riding on manufacturer supplied promotion.[55] With respect to the second type of free-riding, because dealers are being compensated for promotional effort on the basis of total sales (both marginal and infra-marginal), and non-performance is costly to detect, dealers have an incentive not to supply the agreed upon promotional inputs.[56] Exclusive dealing mitigates the incentive to free-ride in this way by increasing the dealer's incentive to promote the manufacturer's product.

Outside of the analysis of dealer free-riding, there are other efficient uses of exclusive dealing. One such use involves the role of exclusive dealing by individual retailers, including those without any market power, to intensify competition by manufacturers for their business and to improve purchase terms. By offering manufacturers access to the retailer's loyal customer base, a retailer is able to commit a substantial fraction of its customers' purchases to the "favored" supplier and thereby dramatically increase each supplier's perceived elasticity of demand by making rival products highly substitutable.[57]

Third, as Alden Abbott and Joshua Wright explain:

> The most common scenario of antitrust relevance involving exclusive dealing contracts concerns an upstream supplier, S, entering into an exclusive dealing contract with retailers, R, who in turn, sell the product to final consumers. The potentially anticompetitive motivation associated with exclusive dealing contracts is clearly related to the limitation placed by that contract on R's ability to sell

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[52] Howard P. Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982).

[53] Benjamin Klein & Andres V. Lerner, *The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty*, 72 ANTITRUST L.J. 473 (2007).

[54] *See* Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J.L. & ECON. 421 (2007), which extends the original analysis of inadequate dealer incentives to promote and the use of vertical restraints in solving this dealer incentive problem in Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265 (1988).

[55] Klein & Lerner, supra note 53, at 497–502.

[56] *Id.* at 502–504.

[57] *Id.* at 507–518.

> rival products to final consumers. The possibility of anticompetitive exclusion arising out of these types of contracts generally arises only if S is able to foreclose rival suppliers from a large enough fraction of the market to deprive those rivals of the opportunity to achieve minimum efficient scale.[58]

As such, determining whether there are anticompetitive effects from exclusive dealing requires a fact-specific case-by-case analysis and is ill-suited to be treated as per se unlawful.

Tying

Article 20(8) prohibits a dominant firm from "[t]ying or imposing unfavorable conditions on customers." For the following reasons, we strongly urge against this per se illegality approach and instead recommend an effect-based approach.

First, tying is ubiquitous and widely used by a variety of firms and for a variety of reasons.[59] In the vast majority of cases, package sales are "easily explained by economies of scope in production or by reductions in transaction and information costs, with an obvious benefit to the seller, the buyer or both."[60] Those benefits can include lower prices for consumers, facilitating entry into new markets, reducing conflicting incentives between manufacturers and their distributors, and mitigating retailer free-riding and other types of agency problems.[61] Moreover, because of the widespread procompetitive use of tying by firms without and firms with market power, making tying per se or presumptively unlawful (i.e., absent evidence of net anticompetitive effects) is likely to generate many Type I (false positive) errors which, as the U.S. Supreme Court has explained, "are especially costly, because they chill the very conduct the antitrust laws are designed to protect."[62]

Second, as the U.S. Supreme Court has observed, the fact that "a purchaser is 'forced' to buy a product he would not have otherwise bought even from another seller" does not imply an "adverse effect on competition."[63] Alden Abbott and Joshua D. Wright explain:

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[58] Abbott & Wright, *supra* at 51, at 194–95.

[59] *See, e.g.*, Kobayashi, *supra* note 2, at 707–08; *see also* THOMAS T. NAGLE & REED K. HOLDEN, THE STRATEGY AND TACTICS OF PRICING: A GUIDE TO PROFITABLE DECISION MAKING (3d ed. 2002); David S. Evans & Michael Salinger, *Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 YALE. J. ON REG. 37 (2005); Stefan Stremersch & Gerard J. Tellis, *Strategic Bundling of Products and Prices: A New Synthesis for Marketing*, 66 J. MARKETING 55 (2002).

[60] Kobayashi, *supra* note 2, at 708; *see also* David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practice: A Neo Chicago Approach*, 72 U. CHI. L. REV. 27 (2005); Stremersch & Tellis, *supra* note 57, at 70.

[61] Kobayashi, *supra* note 2, at 708; *see also* Bruce H. Kobayashi, *Two Tales of Bundling: Implications for the Application of Antitrust Law to Bundled Discounts* (George Mason Univ. Sch. of Law, Law & Econ. Working Paper No. 05-27 (2005)).

[62] *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004) (internal quotation marks omitted).

[63] *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16, 31 (1984).

> This . . . statement [by the U.S. Supreme Court] suggests that bundling would not constitute unlawful tying if the purchaser simply desires to purchase less than the entire bundle of products offered for package sale at a reduced price. Rather, to prevail on an unlawful tying or bundling claim, the plaintiff (or agency) would have to show an exclusionary effect on other sellers as a result of the plaintiff's thwarted desire to purchase substitutes for one or more items in the bundle from other sources that harms competition in the market for the tied product.[64]

As such, we strongly urge that the VAC limit liability to situations in which there is evidence of net anticompetitive harm and apply widely accepted economically-based theories of harm, such as leveraging and monopoly maintenance.[65]

Refusals to Deal

Article 20(10) prohibits a dominant firm from "[r]efusing to deal without plausible reasons." For the following reasons, we strongly urge against this approach.

First, the proposed standard ("without plausible reasons") is unclear.

Second, although a firm's competitors may want to use a particular good or technology in their own products, there are few situations, if any, in which access to a particular good is necessary to compete in a market. Indeed, one of the main reasons not to impose liability for unilateral, unconditional refusals to deal is "pragmatic in nature and concerns the limited abilities of competition authorities and courts to decide whether a facility is truly non-replicable or merely a competitive advantage."[66] For one thing, there are "no reliable economic or evidential techniques for testing whether a facility can be duplicated," and it is often "difficult to distinguish situations in which customers simply have a strong preference for one facility from situations in which objective considerations render their choice unavoidable."[67]

Third, forced competition based on several firms using the same inputs may actually preserve monopolies by removing the requesting party's incentive to develop its own inputs. Consumer welfare is not enhanced only by price competition; it may be significantly improved by the development of new products for which there is an unsatisfied demand. If all competitors share the same facilities this will occur much less quickly if at all. In addition, if competitors can anticipate that they will be allowed to share the same facilities and technologies, the incentives to develop new products is diminished. Also, sharing of a monopoly among several competitors does not in itself increase competition unless it leads to improvements in price and output, i.e., nothing is achieved in terms of enhancing consumer welfare. Competition would be improved

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[64] Abbott & Wright, *supra* note 51, at 188.

[65] Koren W. Wong-Ervin et al., *Tying and Bundling Involving Standard-Essential Patents*, 24 GEO. MASON L. REV. (forthcoming 2017).

[66] ROBERT O'DONOGHUE & JORGE PADILLA, THE LAW AND ECONOMICS OF ARTICLE 102 TFEU 518–19 (2d ed. 2013).

[67] *Id.*

only if the terms upon which access is offered allow the requesting party to effectively compete with the dominant firm on the relevant downstream market. This raises the issue of whether the dominant firm is entitled to charge a monopoly rate or whether, in addition to granting access, there is a duty to offer terms that allow efficient rivals to make a profit.[68]

Lastly, it is important to consider that potential inventors may be less likely to undertake the research and development that lead to an invention or new products if the inventor's reward for its efforts is reduced by having to share its product or intellectual property right.[69] Similarly, if businesses know they can easily gain access to the goods or intellectual property rights of other firms, then they have less incentive to innovate and more incentive instead to free-ride on the risky and expensive research of others.[70] The implication of this analysis is that requiring businesses to deal with competitors is likely to result in less innovation, which will harm consumers in the long run.

CONCLUSION

We appreciate the opportunity to comment and would be happy to respond to any questions the VCA may have regarding this comment.

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[68] *Id.*

[69] *See, e.g.,* O'DONOGHUE & PADILLA, *supra* note 65; J. Gregory Sidak, *How Does the Experience of U.S. Telecommunications Regulation Inform the Forced Sharing of Intellectual Property Rights under Global Competition Law?* (Criterion Econ. Working Paper, 2012), https://ssrn.com/abstract=2061895.

[70] *See Trinko*, 540 U.S. at 408.